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UNCLAS SECTION 01 OF 03 MONROVIA 000725

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TAGS: ECON EINV ENRG EAGR LI
SUBJECT: LIBERIA: BUCHANAN RENEWABLES DEAL STALLS OVER PRICE DISPUTE

REF: MONROVIA 82

¶1. (SBU) SUMMARY: The Government of Liberia may back out of a power purchase agreement with Buchanan Renewables (BR), after a consortium of donors warned the President that unduly high tariffs could threaten the financial solvency of the Liberian Electricity Corporation (LEC) and deter small businesses and residential consumers from connecting to the power grid. BR defends its pricing model based on large up-front investments, the high cost of doing business in Liberia, and the demonstration effect of a "green" power project in a low-income country. To break the impasse, President Sirleaf agreed to accept a professional energy negotiator, but warned she needs a firm recommendation by October 21, because Liberia needs power immediately, and political pressures make further delays untenable. If BR refuses to renegotiate, Liberia will pursue conventional heavy-fuel oil generation. END SUMMARY.

¶2. (SBU) BR signed January 21 a concession agreement with the GOL and a power purchase agreement with LEC for the construction of a 35-megawatt power plant to provide energy to greater Monrovia (ref A). According to the contract, BR will invest $150 million to construct a power plant fueled with woodchips from unproductive rubber trees, and will build a transmission line to Monrovia. The Overseas Private Investment Corporation (OPIC) approved a $112 million loan for the project, and BR would fund the remainder with private equity. BR is seeking final agreement with the GOL on the tariff in order to achieve financial closure and commence construction of the power plant.

¶3. (SBU) Separately, Buchanan Renewables Fuel (BRF), an independent subsidiary of parent company Buchanan Renewables B.V., will sell the woodchips to its sister company, and pledged to plant at least one rubber sapling for each felled tree, offsetting the carbon released by the power plant. The BRF project promises additional benefits to small-scale rubber growers without the means to replant their farms. To date, OPIC has disbursed $15 million to BRF, which has begun exporting rubber wood chips to Europe from the port of Buchanan. Two shiploads have already been exported and BRF has contracts with utilities in Norway and Sweden to supply more.

¶4. (SBU) BR estimates power generation will cost 23 cents per kilowatt hour, roughly half the cost of diesel-fueled generators or the donor-funded fuel-oil powered 10 MW Emergency Power Program, but well above international norms for hydroelectric energy (5-8 cents) and heavy-fuel oil (12-14 cents). BR's pricing structure seemed a palatable interim measure in mid-2008, when oil prices were at record highs. Hydroelectric also remains a distant and capital-intensive solution, as rehabilitation of the Mt. Coffee Hydroelectric Dam will require $500 million in investment.

¶5. (SBU) However, as donors began planning a management contract for LEC, it became apparent that BR's tariffs might imperil the off-taker's long-term self-sufficiency and compel the GOL to furnish a subsidy its budget could not bear. The International Financial Corporation (IFC) and the Government of Norway commissioned an independent expert to analyze BR's pricing model, and the draft

report, released September 4, questions the underlying methodology used to calculate the tariff and concludes BR's pricing is nearly double what the LEC should be willing to pay. The study further notes BR's oft-touted claims of carbon neutrality cannot be verified without a comprehensive environmental impact assessment.

Fuel At What Price?

¶6. (SBU) The report attacks BR's pricing model on two fronts. First, the author asserts BR's claim to require $149 million in up-front investment is inflated, estimating the cost of comparable biomass plants in similarly developed countries at no more than $70 million. Second, the author argues BR overstates the true value of its fuel source, which it purchases from sister company BRF. While BR intends to charge the LEC $60 per ton based on the opportunity cost of exporting wood chips to Europe, the report suggests that transportation costs make Liberian wood chips too expensive for export. The report concludes BR could charge 12.5 cents per kWH, yielding a healthy return on equity of 25 percent, while sparing LEC and the GOL from unsustainable subsidies.

¶7. (SBU) In a written response September 14, BR refutes these conclusions, calling the assumptions "highly speculative," charging the report's author with using outdated data, and observing that he never visited Liberia to examine operations. In a September 25 meeting with Econoff, Don Durand, chief operating officer at Buchanan Renewables, defended both components of BR's pricing. He accused the author of making misleading comparisons between Liberia and other more developed and thus low-cost markets, and cited the necessity of importing all heavy equipment, constructing roads, and

renovating the port at Buchanan as extraordinary costs that drive the high fixed investment. Further, he dismissed the notion that given the absence of an export market, fuel costs should not exceed $43 per ton of rubber chips. He stated BRF has signed a three-year contract with the Swedish utility Vattenfall to provide two million tons of rubber chips annually at a cost of $68 per ton, and a five-year contract with Norway Biowood at $69 per ton.

Carbon Neutrality and Productive Farmers?

¶8. (SBU) But BR seems disinclined to renegotiate the 23 cent tariff, questioning why a pricing model that has remained consistent for more than a year is now so hotly disputed. Instead, it argues the project offers intangible social, economic and environmental benefits that a conventional heavy-fuel oil plant lacks. BR claims the biomass plant may pilot a new model for green energy production in low-income but timber-rich countries, and asserts that use of indigenous rubber wood frees Liberia from both the foreign exchange risk and inflation-provoking vagaries of global oil prices.

¶9. (SBU) Much of BR's pricing defense hinges upon the environmental and social benefits that accrue to sister company BRF. By removing unproductive rubber trees, BRF claims to accelerate farm rejuvenation, offset otherwise prohibitive costs to smallholders, and unlock income and employment opportunities for rural populations. It argues that replanting trees would make the power plant carbon neutral. However, given the success of the rubber chip export business, the benefits to small-scale farmers would remain, even if BR never builds its power plant.

¶10. (SBU) In a line-by-line refutation of the IFC/GON report, BR maintains it possesses detailed data and documentation supporting its claims. However, the company has yet to share an environmental impact assessment, projections of income-generation for small holders, or an engineering feasibility study, stating only that they submitted documents to OPIC's satisfaction.

A Negotiated Solution?

¶11. (SBU) President Sirleaf, swayed by the IFC/GON report but impatient for immediate progress in the energy sector, convened a

meeting between donors and BR October 1. While receptive to donor concerns, she warned she is under political pressure to provide lower-cost energy, and cannot tolerate further roadblocks, whether from donors, BR or her own staff. She accepted donors' offer to hire a professional energy negotiator and advised BR to cooperate fully and furnish documents it had previously withheld. The President set a deadline of October 21, saying she would make a final decision on whether to move forward with the BR deal based on the negotiator's written recommendations.

¶12. (SBU) Even if all parties break the stalemate, the President said she will pursue other options to avoid a BR energy monopoly. The GOL plans to issue an expression of interest for a 20-megawatt heavy-fuel oil (HFO) independent power project, and the President said Soros Economic Development Fund may provide some financing. [Note: American firms such as Contour Global and Ormeco International, sensing the GOL's flagging enthusiasm for BR, have made exploratory trips to Monrovia in recent months, and assured Econoffs they could deliver power production by the end of 2010, according to BR's original timeframe, but at less than half the cost. End Note.]

COMMENT

¶13. (SBU) The proposed tariff is untenable. Beyond the question of a viable management contract and subsidies to LEC, expensive power hobbles economic growth and sets formidable barriers to entry for would-be entrepreneurs. USAID will continue to advocate for a transparent and competitive process that puts the long-term interests of Liberia first.

¶14. (SBU) BR's reluctance to renegotiate with the GOL or share information with donors may be within its rights, but it provokes avoidable suspicion and limits donors' inclination to defend the project's strengths. Greeted two years ago as a new model for green investment and the solution to Liberia's energy shortage, BR appears alarmed by its fast-eroding political clout, and seems to be circling the wagons. We hope that its intractable stance on pricing is a negotiating tactic rather than a definitive assessment of its own long-term interests. A failing LEC with tariffs too high to sustain an increasing base of residential and small business customers cannot be BR's recipe for sustained growth; if a negotiator compels BR to recognize this reality, a deal may still be salvaged.

¶15. (SBU) If BR fails to lower the tariff, heavy-fuel oil may be a viable interim solution, bridging the gap between diesel and lower-price hydroelectric and biomass options. BR's model may be less novel than they represent; equipment for biomass and biofuel power plants is widely manufactured, and another provider could replicate BR's project in three years' time. However, the GOL will need to carefully ensure that the unraveling of a highly-publicized project does not discourage future infrastructure investment.

¶16. (SBU) BRF, for its part, has invested too much to abandon Liberia entirely. The parent company threatens to withdraw if the BR deal flounders, imperiling hundreds of jobs in Buchanan. But given that the wood chip export business appears to be a growth industry, BRF's presence is likely assured, and the benefits to small-scale rubber farmers will persist. Further, the parent company would maintain its technical services subsidiary, which employs otherwise-idle heavy machinery on road construction and port operations.

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